



December 14, 2018

Via real-time electronic submission

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Avenue, NW
Washington, DC 20551

Re: Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments,
Docket No. OP-1625

Ladies and Gentlemen:

On behalf of the nation's retailers, the National Retail Federation ("NRF") is pleased to submit this letter in support of the Federal Reserve Board's proposal to implement Real Time Gross Settlement ("RTGS") to serve participants in the U.S. payment system. We look forward to continuing to provide feedback around this and other much-needed modernization initiatives.

NRF is an important voice in advancing the US payment systems for all stakeholders

NRF is the world's largest retail trade association, representing discount and department stores, home goods and specialty stores, Main Street merchants, grocers, wholesalers, chain restaurants, and internet retailers in the United States and more than 45 countries. Retail is the largest private-sector employer in the United States, supporting one in four U.S. jobs – approximately 42 million American workers – and contributing \$2.6 trillion to annual GDP. As the industry umbrella group, NRF has offered testimony and guidance on the cost, efficiency, and security of the US payment system.¹ Our members are among the payment system's most important stakeholders. As merchants who sell goods and services, in person and through eCommerce channels, to millions of customers each day, our platforms provide the interaction

¹ See, e.g., "NRF Letter to Federal Trade Commission regarding Competition and Consumer Protection in the 21st Century Hearings," August 20, 2018, available at https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0050-d-0035-155060.pdf; "Testimony of Mallory Duncan, General Counsel and Senior Vice President, National Retail Federation, Before the Senate Banking, Housing, and Urban Affairs Subcommittee on National Security and International Trade and Finance, on Safeguarding Consumers' Financial Data," February 3, 2014, available at <https://www.banking.senate.gov/imo/media/doc/DuncanTestimony2314NSITF.pdf>; Letter to House Financial Services Committee Regarding Financial Choice Act, April 26, 2017, available at <https://nrf.com/media-center/press-releases/retailers-ask-congress-protect-swipe-fee-reform-has-saved-consumers>.

between these consumers, on the one hand, and on the other hand, numerous banks, card networks, mobile payment apps, and other modalities.

NRF and our member companies have been active in communicating with the Federal Reserve Board (“the Fed”) about the state of, and reforms to, the payment system. NRF has participated in the Federal Reserve Board’s Secure and Faster Payments Task Forces, and has recently offered feedback through the Fed’s portal on several recent topics. We meet regularly with appropriate staff to discuss routing competition and debit network fees. NRF’s comments on RTGS reflect our primary goals for improving the ways that our customers make millions of payments every day: We all need faster, cheaper, more secure, and more numerous payment options in order to become the most advanced payments economy in the world.

Innovation in payment methods requires government action to spur better and cheaper payment systems for all stakeholders

Fifty years ago, merchants were presented with limited choices for accepting payments from consumers. They could accept cash, which for years, was the undisputed “king” of commerce; they could accept paper checks; they could accept a branded card, such as Visa, Mastercard, Discover, Diners Club, or American Express, using a manual card impression machine, while settling receipts from these providers via mail on a daily or weekly basis; or, they could offer store credit or financing.

Our current payment system has achieved obvious refinements from that of half a century ago. Yet its basic infrastructure is all too recognizable, with improvements that are hardly revolutionary in ways that one would expect in a robust, competitive market. Cash and checks are still accepted, although checks have been largely phased out in many settings in favor of ACH-based electronic payments. Despite the lightning speed of communication via the Internet, bank payment settlement is still done in delayed batches. And, the dominant card networks look strikingly similar to how they looked five decades ago (except that Diners Club has merged with Discover). While the old “knuckle buster” card impression machine has gone the way of the manual typewriter, the replacement technology – EMVCo chip readers – until earlier this year still relied on a customer’s signature to verify that person’s identity.

Online and mobile transactions have catalyzed advancements in the payment ecosystem. These innovations have not, however, pushed the payment system beyond the traditional “rails” – the existing credit and debit networks, and to a lesser extent ACH, The Clearing House, and a handful of apps. The first “wallet” of sorts, Paypal, came online in 1998. Paypal did make it possible for users to employ the direct transfer mechanisms of ACH, which in theory, should have helped to drive transaction costs down on other payment methods. However, neither Paypal’s integration of non-card network payment solutions, nor similar innovators, were able effectively to compete with the overall market dominance of the card networks.²

² The 3-5 day settlement time for ACH transactions – while they appeared “instant” to the consumer – may have been a reason that competition did not actually emerge.

The market dominance of private card networks has undoubtedly slowed innovation in the US payments system. One need look no further for proof that the card networks exercise substantial market power in the US than the interchange and network fees that the card brands and issuers are able to charge merchants—fees that have only increased in the last several decades. Between 2000 and 2006, interchange fees paid by merchants more than doubled, to \$36 billion.³ By 2016, card fees hit \$88.39 billion – another increase of more than 100 percent.⁴ During this period, the “Durbin Amendment,” which limited the debit fees that networks could charge on behalf of most large-bank issuers, was implemented—and yet overall card fees still rose dramatically. We can deduce that the increase in fees after implementation of the Durbin Amendment is attributable to fee increases for the credit networks, after debit network fees were reined in for the larger banks.

While the cost of accepting payments has sprinted skyward, the rate of innovation within the payment sector in the US has not kept up. When EMVCo chip-and-signature cards were rolled out in the US market (many years after the rest of the world), they were not generally implemented with the capability for merchants to request a customer PIN at the point of sale – unlike most of the rest of markets that used chip cards. And, while the card networks and issuing banks have imposed security standards through EMVCo and PCI DSS, and have developed propriety anti-fraud protections for US merchants to use (such as 3D Secure (“3DS”) and Visa Tokenization), these technologies are provided by a single entity and do not yield shared and transparent responsibility for fraud. Because the means that are offered to merchants to make payments systems more secure are proprietary, and their use is often required by the card networks as the only way to avoid liability for fraudulent payments, they are not necessarily state-of-the-art. Instead, these solutions function as add-ons and are not baked in to the architecture of the payment system. And some of these technologies are fundamentally unattractive to merchants and customers alike because they can create friction for customers.⁵ At the end of the day, payment security is not where it should be in the United States. The U.S. is responsible for roughly 23.7 percent of global purchase volume, but 38.6 percent of gross card fraud losses.⁶

There are plenty of use cases around the world, as discussed below, for the notion that government action is necessary to speed the adoption of new payment technologies. In fact, as the Fed itself has observed in its Request for Comment, the role that governments play in

³ “Hearing Before the Antitrust Task Force of the Committee on the Judiciary, House of Representatives,” July 19, 2007, available at <https://www.gpo.gov/fdsys/pkg/CHRG-110hhrg36785/html/CHRG-110hhrg36785.htm>.

⁴ “US Merchants Paid \$88.39 Billion in Card Fees in 2016,” The Nilson Report Merchant Fees Report, May 18, 2017, available at https://nilsonreport.com/upload/pdf/U.S._Merchants_Paid_88.39_Billion_in_Card_Fees_in_2016_The_Nilson_Report.pdf.

⁵ For example, the first iteration of 3DS created unworkable friction for customers and was therefore not widely adopted. By 2017, the outlook for 3DS was slightly better: 22 percent of merchants surveyed by Aite group said they were using 3DS on at least one channel, while another 16 percent planned to deploy it.”CNP Fraud Around the World,” US Payments Forum, March 2017, available at <http://www.uspaymentsforum.org/wp-content/uploads/2017/03/CNP-Fraud-Around-the-World-WP-FINAL-Mar-2017.pdf>.

⁶ “Card Fraud Losses Reach \$24.26 Billion,” The Nilson Report, November 2018.

facilitating faster payments is indispensable. A recent study by SWIFT concluded that the difference between a “typical adoption path” and a “rapid adoption path” is the difference in the roles that the regulators play. “In general, [real-time payment] adoption is rapid where the regulator encourages adoption, where the entire banking community commits to the initiative, and where the end customer sees value or can leverage new tools.”⁷

NRF believes that the movement by the Federal Reserve towards implementing 24/7/365 settlement services will spur innovation in payments. The availability of real-time settlement will likely seed other innovations, whether they are implemented directly by the Fed as auxiliary services or developed by the private sector. Entrants into the faster payments space are the most likely candidates to create the attractive payment alternatives that merchants are most likely to adopt, and widespread adoption of a faster payment service will inevitably catalyze other payment providers to improve the cost and security of their services.⁸ This, in turn will create a virtuous cycle of innovation and demand, and should enable the Federal Reserve to achieve full cost recovery while fostering a competitive market. As many stakeholders who were interviewed by the GAO observed, the Fed is uniquely positioned to lead to widespread adoption of an efficient payment service, as financial institutions already use the Fed for settlement services.⁹

To achieve the twin goals of lower cost and greater security, NRF urges the Fed to ensure that 24/7/365 payments are implemented as an interoperable and accessible solution that provides real-time settlement through use on multiple platforms as they develop. The cost-effectiveness and security of payment alternatives would be further enhanced by additional and/or auxiliary services such as: open banking, which has been used successfully around the world to allow new market entrants to invent innovative payment methods based on standardized coding that means stringent security standards; and value-added messaging capabilities (provided as an auxiliary service by the Fed or by private actors), to allow the billers and other payees to send a request for payment to the consumer, who then pushes payment to the biller. The consumer can pay instantly without exposing unnecessary financial information to the biller.

Other countries are far ahead of the US in developing new payment methods

It is undisputed that the United States has given birth to the most advanced and rapid technological changes in the last 50 years. However, our payment system has lagged behind markets around the world. The Request for Comment recognizes that “[b]oth advanced and emerging economies have undertaken efforts to develop faster payment services, and those services are now broadly accessible to the general public in an increasing number of countries.”¹⁰

⁷ “The Global Adoption of Real-Time Retail Payments Systems (RT-RPS), SWIFT White Paper, 2015.

⁸ So far, only one entrant has provided a payment solution that could be so characterized as providing faster payments, but it has not yet seen wide adoption and is owned directly by financial institutions.

⁹ NRF also believes that increasing the capabilities of ACH and other networks – through, for example, improving settlement and liquidity management—are important steps that the Fed should consider.

¹⁰ Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Request for Comments, 83 Fed. Reg. 57351, 57353, November 15, 2018.

NRF believes that RTGS, if implemented in an interoperable framework, will lead to much-needed advancement of payments in the US.

This year, an FIS study found that there are 40 active real-time payment programs around the world, up from 25 in 2017. FIS rated payment programs in India, Australia, and Singapore as the fastest and most advanced in terms of openness and security. Australia in particular provides an instructive example: Launched just this year, Australia used an open infrastructure along with instant payments to offer customers a suite of services, including data control, which are likely to lead to adoption beyond the government and bill payment realms.¹¹ China's payment system has innovated beyond financial services institutions to payment facilitators such as Alipay and WeChat – which, notably for consumers and merchants alike, means that there are no per-transaction interchange fees charged by issuing banks. Observers have noted that the \$90 billion a year that US merchants and consumers pay to process credit cards and mobile payments could, at least in part, be redirected towards better and faster networks that provide consumers with more control over their payments and their payment data.¹²

Undoubtedly, financial institutions and card networks have provided added value to merchants and consumers, in the form of a convenient and reliable payments that are accessible to the vast majority of Americans. But much more needs to be done to bring the US into the secure, fast and frictionless payments market that is enjoyed in many other countries. And RTGS, coupled with other improvements to the payment system, will leverage banks' ability to provide increasing value to consumers, while welcoming other innovative service providers into the market. We look forward to working with banks and other stakeholders on liquidity and cash management solutions, risk management, security improvement and innovation, and other issues that are important to our members our members' customers.

RTGS is an important first step towards addressing merchants' and consumers' specific concerns about increased fraud and lack of choice in payments

Faster payments are not generally thought of as primarily providing security-related enhancements to the payment system. But faster payments could help to drive better security and authentication throughout the payment system in two ways. First, faster payments result in the immediate transfer of money from the payor to the payee, which necessitate strong antifraud measures. When faster payments were first rolled out in the UK, fraudulent transactions tripled, according to the behavioral biometrics firm Biocatch. When transaction entry points were secured, using such security features as multi-factor authentication, behavioral analysis, and biometrics, fraud rates dropped. We hope and expect that faster payments in the US will similarly go hand-in-hand with anti-fraud innovations that will bring down the country's already disproportionate rate of fraud as it already exists (discussed above).

¹¹ Flavors of Fast Report 2018, FIS, available by subscription.

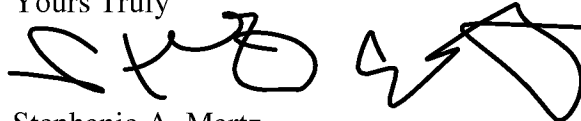
¹² "Why China's Payment Apps Give U.S. Bankers Nightmares," Jennifer Surane and Christopher Cannon, Bloomberg LP, May 23, 2018, available at <https://www.bloomberg.com/graphics/2018-payment-systems-china-usa/>.

Second, interoperable and ubiquitous RTGS that is enabled and supported by the Fed's existing structures will ultimately enhance the security of payments throughout the ecosystem by not only creating more competition among payment methods, but by enabling the entry of more payment services that are accessible to smaller financial institutions, service providers, and merchants. In this regard, the Fed could and should consider measures that will ultimately (directly or indirectly) improve the security of existing as well as nascent payment systems by, for example, incorporating security standards into usage requirements for RTGS, enabling aliases rather than account numbers to initiate transactions, developing a strong security profile for open banking, as well as instituting security standards for other services that the Fed could facilitate or mandate. The Fed's multi-year work through the Secure Payments Task Force, in which stakeholders assessed the risks of existing security methods in the various payment infrastructures, serves to pinpoint the problems that improved payment methods can solve.

Fraud in the payment system is top-of-mind for NRF's members. In a wide-ranging survey of retailers conducted by NRF and Forrester this year, retailers were asked, "What are the top three payment-related challenges that your team has faced in the last 12 months?" Fraud emerged as the top answer, with 55 percent of respondents agreeing that it is their number one concern. Ninety-five percent of retailers said they agreed that requiring issuers to enable PINs on financial transactions would improve security, but as noted above, networks and issuers have declined to do so in the US. Sixty-two percent of retailers said they would implement biometrics if banks enabled it. But issuers and networks have similarly not made these solutions available to merchants, and insofar as security measures like biometric authentication are built-in to NFC payments (as through unlocking a phone), policies that require merchants to accept all forms of NFC payment, rather than selecting among them, have discouraged rapid adoption.¹³ These policies are set by the incumbent card networks, and serve as a case-in-point for why NRF's members welcome innovation in the payment market.

In sum, from the perspective of NRF's members, there is no better time for the Fed to implement faster payments, and more generally, to move forward with improving the speed and security of our payment system. US consumers deserve to have the fastest and most secure payment system in the world, and should be able to choose a method of payment that suits their own needs and priorities. NRF looks forward to working with the Fed through future collaboration to achieve this goal.

Yours Truly

A handwritten signature in black ink, appearing to read 'Stephanie A. Martz', with a stylized flourish at the end.

Stephanie A. Martz
Senior Vice President and General Counsel
National Retail Federation

¹³ NRF and Forrester, "State of Retail Payments: Outlook 2019."